

State of California
Department of Insurance
45 Fremont Street, 21st Floor
San Francisco, California 94105

**ADOPTION OF REGULATION
ON AN EMERGENCY BASIS PURSUANT TO
CALIFORNIA GOVERNMENT CODE SECTION 11346.1(b)**

**Section 2361. CONSIDERATION OF LOSSES AND LOSS EXPOSURE IN
RESIDENTIAL PROPERTY INSURANCE RATING AND UNDERWRITING**

File No. ER03030135

July 21, 2003

Adopt Title 10, California Code of Regulations, Chapter 5, Subchapter 3, Article 7.2, Section 2361.

California Insurance Commissioner John Garamendi (“the Commissioner”) hereby adopts on an emergency basis a new regulation: CCR §2361 of Article 7.2 of Subchapter 3 of Chapter 5 of Title 10 of the California Code of Regulations (CCR).

A. Emergency Regulations Text and STD. Form 400.

The text of the regulation is attached. The STD. Form 400 was submitted to OAL on July 10, 2003.

B. Agency Express Finding of Emergency.

The Commissioner finds that for the specific reasons explained below an emergency exists which makes the immediate promulgation of this regulation on an emergency basis necessary for the preservation of the public peace, health, safety and general welfare.

C. Agency statement of specific facts showing the need for immediate action.

1. Introduction

A convergence of forces and unforeseen circumstances has come together in California to create a crisis in the residential property insurance¹ market. For the reasons explained below California currently faces an extreme shortage of available homeowners insurance. The insurance industry, consumer protection groups, the press and the general public have all become aware of the situation. The crisis is of such a scope and magnitude that the Commissioner believes immediate action is required to avert any further deterioration of the residential property insurance market.

While there are laws specific to insurance rating and underwriting that address cancellation, nonrenewal and eligibility for homeowners insurance, both the insurance industry and the

¹ Residential property insurance is more commonly known as “homeowners” insurance.

insurance consuming public are unclear as to the exact application of these laws. This regulation is specifically designed to define, clarify and make specific the application of these laws in California.

2. Cancellation, Nonrenewal and Eligibility

The crisis to which we refer centers around the cancellation and nonrenewal of existing homeowners coverage and a general lack of availability due to underwriting and eligibility guidelines applied by insurers that appear in many cases to be in noncompliance with the current insurance laws. The situation has been referred to in the press, and by the Commissioner, as “use it and lose it.” Under this scenario, even simple coverage inquiries have been used as the basis for cancellation and nonrenewal of insurance coverage.

Many of the problems in this area can be traced to the use of loss data bases compiled by various insurance-support organizations. The Commissioner has ample evidence in the form of consumer complaints and media reports to believe that much of the data contained in these databases is imperfect and inconsistent, and reliance upon these imperfect and inconsistent databases may result in unfairly discriminatory treatment of policyholders and applicants. Even where the data in the databases is not flawed, current law in California requires that underwriting decisions not be based solely on the contents of the databases but only after further information is gathered from a source or sources other than that gathered from the insurance-support organization. Also, current law requires insurers to evaluate the risk of future loss in making any underwriting decision. The Commissioner believes that insurance industry reliance on these databases is exacerbating the availability crisis and that, if field exams can be used as a barometer, many insurers are foregoing the required underwriting evaluations.

By defining certain terms and providing concrete examples this regulation is designed to clear up any ambiguity in this area of the insurance law. The Commissioner believes that until such time as this regulation is promulgated, the crisis will continue and insurers will continue to forego the underwriting evaluations currently required by law.

3. Consumer Complaints

CDI has recently experienced an unprecedented increase in complaints from consumers regarding homeowners insurance cancellation, nonrenewal and eligibility in homeowners insurance lines.

CDI also has received voluminous complaints from policyholders who have been denied coverage or had coverage terminated due to insurance company reliance solely on insurance-support organization databases that have been shown to rely on and contain incomplete or erroneous loss history data.

Throughout 2001, CDI received only 318 formal complaints regarding homeowners insurance. In contrast, by the third quarter of 2002, CDI had received 1,200 written complaints from consumers, making the subject of homeowners insurance the number one consumer complaint

issue in Property and Casualty lines at the Department of Insurance. CDI continues to receive an inordinate number of complaints relating to homeowners coverage.

As of March 2003, formal complaints regarding homeowner non-renewal as they relate to insurance-support organization databases are pacing at the same rate they did in late 2002, exceeding 100 per month.

An increase of this magnitude in the number of complaints indicates that not only does there exist an emergency in the homeowners insurance market in California, but that if action is not taken immediately the crisis will continue to worsen.

Below is a thumbnail schedule of complaints received by CDI relating to the issues addressed by these regulations.

	7/1/01 - 6/30/02	7/1/02 - 6/30/03	% Increase
Refusal to Insure	311	578	85%
Cancellation	573	939	64%
Nonrenewal	1007	1713	70%
Totals	1891	3230	71%

The Commissioner believes these numbers show a significant and severe trend.

4. Availability Crisis

The Commissioner believes that the unprecedented increase in the number of complaints relating to cancellation, nonrenewal, and unavailability of homeowners insurance evidences a homeowners insurance availability crisis in California. The repercussions of such a crisis threaten immediate harm in the real estate and financial markets and threaten to further undermine an already fragile California economy. A crisis of this kind also has an immediate and profound effect on the consumers of this state who, due to an inability to secure coverage, may be unable to either purchase or sell a home or who upon cancellation may be involuntarily transferred into the costly residual or forced-place insurance markets. The number of people affected by the crisis grows daily.

The Commissioner believes that a significant number of Californians have found it impossible to purchase insurance or had their insurance cancelled or not renewed due to acts that may be in noncompliance with the California Insurance Code and California Code of Regulations. Many insurers in applying cancellation, nonrenewal and underwriting rules that are not clearly defined, or that rely solely on imperfect and inconsistent databases alone, have aggravated the insurance availability crisis in California.

This crisis is evidenced in the startling increase in the number of consumer complaints received by CDI and by scores of media reports on the lack of availability of homeowners policies. Indeed, in Sacramento the homeowner's availability crisis has been at the top of the legislative

agenda all year though as of the time of this writing no legislation has moved out of committee and onto the floor of either the Senate or the Assembly. The Commissioner has also been in communication with the real estate and financial industries and with various constituents who are being effected by this crisis.

5. The Legal Challenge

The Commissioner recognizes the growing problem of homeowner insurance availability and has worked hard to find solutions. He has attempted to resolve the situation by working with individual insurers on a one on one basis. He has attempted to communicate his concerns to the industry as a whole. Not only has there been no discernable improvement in the situation but these efforts have been met with a lawsuit challenging the Commissioner's authority to enforce the insurance laws. (American Insurance Association; Association of California Insurance Companies; Personal Insurance Federation of California v. John Garamendi, Superior Court of the State of California, County of Sacramento, Case No. 03CS00839.)

During the course of the hearing challenging the Commissioner's authority to enforce the insurance laws, which took place on June 12, 2003, counsel for the insurance industry stated that an emergency exists in the California homeowners insurance market due to inherent ambiguity in the law. The judge, Superior Court Judge Raymond M. Cadei, agreed with counsel for the industry that an emergency exists in the California homeowners insurance market due to inherent ambiguity in the law. This regulation is designed to make clear and precise the application of the law in California, applying the formal rulemaking procedure as CDI was instructed by the court to do and is specifically designed to clear up any and all ambiguity as to the application of the insurance laws in this area.

The Court's preliminary conclusion and ruling was that the Commissioner's communication with the industry should have been accomplished through, or pursuant to, the Administrative Procedure Act. Until such time as the court rules otherwise, or these regulations are adopted, the Commissioner faces legal challenge if he seeks to enforce existing law. Not only is this situation both untenable, it tends to implicate problems of Constitutional proportion.

Since the court's ruling CDI has been prevented from processing approximately 100 consumer complaints. The number of consumer complaints that cannot be processed due to the court's order grows daily. Until such time as this regulation is promulgated, the crisis will continue. Therefore, the Commissioner believes that the situation must be remedied as swiftly as possible.

In light of the ruling discussed above, at the current time, if the Commissioner is to perform his statutory obligation to enforce the insurance laws of this state and protect the interests of consumers and the insurance industry alike, he has no other avenue to pursue than promulgation of these regulations on an emergency basis.

Given the availability crisis as described above, and given the Insurance Commissioner's current inability to apply the laws without legal challenge, there exist good reason for the recognition of an emergency.

6. Conclusion

The Commissioner is currently enjoined from enforcing the homeowners insurance laws, at a time when the state of the homeowners insurance market in California is in turmoil. The Commissioner believes an emergency within the meaning of Government Code §11346.1 exists and therefore promulgates this regulation on an emergency basis.

D. Authority and Reference Citations.

The purpose of the regulation is to implement, interpret, and make specific the provisions of California Insurance Code sections CIC §§675, 676, 679.71, 790 et seq., 791.02, 791.10(a), 791.12(b), 1857(a), 1857.2, 1857.3, 1857.7, 1857.9, 1861.05(a), 1861.05(b), 1861.03(a), and 12926.

E. Informative Digest.

The following describes the specific purpose of each provision of this emergency regulation and the rationale for the determination that each regulation is reasonably necessary to carry out the purpose for which it is proposed.

1. Summary of Existing Law

CIC §675 defines residential property risks. The proposed regulations refer to this definition in defining the scope of the proposed regulation.

CIC §676 provides the legal requirements for a valid notice of cancellation and non-renewal of a residential property insurance policy. The proposed regulation applies to cancellation and non-renewal of residential property insurance in relation to an “adverse underwriting decision” as defined in CIC §791.03. The proposed regulation clarifies acts that may violate CIC §676.

CIC §679.71 provides an insurer may not refuse to issue a policy of residential property insurance under conditions less favorable to the potential insured than to other comparable potential insureds. The proposed regulation makes clear that loss history falls within the definition of “personal information” within the meaning of CIC 791.02 and that basing an adverse underwriting decision solely on information garnered from insurance-support organization databases may result in a violation of CIC §679.71.

Based on the experience of numerous consumer complaints, and upon the experience of CDI personnel, the Commissioner has determined that in general loss history databases are prone to contain, or be based upon, faulty and / or incomplete data. Therefore the use of these databases, without gathering further information, may be unfairly discriminatory within the meaning of CIC §679.71. The proposed regulation outlines the steps that need to be taken in order to avoid noncompliance with CIC §679.71.

CIC §790 et seq. provides for regulation of trade practices in the business of insurance. These sections define prohibited acts and lists unfair and deceptive acts or practices. This regulation clarifies acts that may violate CIC §790 et seq.

CIC §790.06 provides that under certain circumstances the Commissioner may define what constitutes an unfair insurance practice in noncompliance with CIC §790.03. Certainly any act or practice that was determined to be unfairly discriminatory, per any of the laws pertaining to unfair discrimination, would meet the definition of an unfair insurance business practice.

Based on the experience of numerous consumer complaints, and upon the experience of CDI personnel, the Commissioner has determined that in general loss history databases are prone to contain, or be based upon, faulty and / or incomplete data. Adverse underwriting decisions made without gathering further information, may be unfairly discriminatory within the meaning of CIC §§1861.05 and 679.71. The proposed regulation outlines the steps that need to be taken in order to avoid the strictures of these laws. Unfair discrimination would most certainly be an unfair insurance practice within the meaning of CIC §790.06.

CIC §791.02 provides the definition of adverse underwriting decision used in this regulation. This regulation, through the use of concrete examples, makes more specific this section.

CIC §790.10 provides that the commissioner shall promulgate reasonable rules and regulations to administer CIC §790 et seq. This section permits the Department to adopt regulations to interpret and make specific CIC §790 et seq. This regulation clarifies acts that may violate CIC §790 et seq.

CIC §791.12(b) provides that an insurer may not predicate an adverse underwriting decision on information gathered from an insurance-support organization unless it obtains “further personal information” from some source other than the insurance-support organization. This regulation, through the use of concrete examples, makes more specific this section.

CIC §1857(a) provides, in pertinent part: Every insurer . . . shall maintain reasonable records, of the type and kind reasonably adapted to its method of operation, of its experience . . . of the data, statistics, or information collected or used by it in connection with the rates, rating plans, rating systems, underwriting rules . . . so that those records will be available at all reasonable times to enable the commissioner to determine whether that . . . in the case of an insurer, every rate, rating plan, and rating system made or used by it, complies with the provisions of this chapter applicable to it.

The proposed regulation makes the records requirements in CIC §1857(a) more specific by detailing exactly the kind of records that must be kept in relation to compliance with the various insurance laws regarding, “rates, rating plans, rating systems, underwriting rules.”

CIC §1857.2 provides for examination of the rates and rating systems of insurers. The proposed regulation makes the examination requirements in CIC §1857.2 more specific by detailing exactly the kind of records that must be kept in relation to compliance with the various insurance laws regarding, “rates, rating plans, rating systems, underwriting rules.”

CIC §1857.3 provides who is subject to examination pursuant to CIC §1857 and what documents or records shall be examined. The proposed regulation makes the records requirements in CIC §1857.3 more specific by detailing exactly the kind of records that must be kept in relation to compliance with the various insurance laws regarding, “rates, rating plans, rating systems, underwriting rules.”

CIC §1857.7 provides the contents of a rate change application. This section necessarily relates to underwriting for a number of reasons. Rates are numbers that are applied through underwriting. The assessment of risk in relation to the potential insured or the potential property to be insured is made by the gathering of information about the insured and the property to be insured. This information is applied, at least in part, through underwriting rules and guidelines. Failure to maintain underwriting guidelines that are sufficiently specific may result in an unfairly discriminatory rate (CCR §2360.2). Underwriting rules that may be sufficiently specific may nonetheless be applied in an unfairly discriminatory manner. The rate charged based on unfairly discriminatory underwriting would be an unfairly discriminatory rate.

The proposed regulation, through the use of concrete examples, makes more specific this section of the CIC as it relates to residential property underwriting.

CIC §1857.9 provides that insurers must report certain information as specified by the commissioner. This section also deals with the recording and reporting of loss and expense experience. The proposed regulation, as it clarifies consideration of losses and loss exposure in residential property underwriting and makes more specific this section of the CIC as it relates to residential property underwriting.

CIC §1861.05(a) provides: No rate shall remain in effect that is excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter. This section necessarily relates to underwriting for a number of reasons. Rates are numbers that are applied through underwriting. The assessment of risk in relation to the potential insured or the potential property to be insured is made by the gathering of information about the insured and the property to be insured. This information is applied, at least in part, through underwriting rules and guidelines. Failure to maintain underwriting guidelines that are sufficiently specific may result in an unfairly discriminatory rate (CCR §2360.2). Underwriting rules that may be sufficiently specific may nonetheless be applied in an unfairly discriminatory manner. The rate charged based on unfairly discriminatory underwriting would be an unfairly discriminatory rate.

The proposed regulation, through the use of concrete examples, makes more specific this section of the CIC as it relates to residential property underwriting.

The question as to whether the Commissioner has jurisdiction over underwriting was put the rest in *Wilson v. Fair Employment and Housing*, 46 Cal. App. 4th 1213, 1223; 54 Cal. Rptr. 2d 419, 424; (1996) where the court stated: . . .the Insurance Commissioner clearly possesses the expertise to evaluate and resolve issues regarding actuarial risks and allegedly discriminatory underwriting practices.

Furthermore, CIC §1858 provides that “any person aggrieved by any rate charged, rating plan, rating system, or underwriting rule” may file a complaint with the commissioner. If the commissioner believes that probable cause for the complaint exists, the commissioner shall notify the insurer. It is the commissioner who makes the determination whether the insurer is in compliance with the law and it is clear that this includes examination of an insurers underwriting guidelines.

We would also take note that the Office of Administrative Law has also held that CIC §1861.05 prohibition against unfair discrimination extends to underwriting. In *2000 OAL Determination No. 15*, the insurer requesting (the “requester”) the OAL determination argued that CIC §§1861.01 and 1861.05 applied only to rates and not to underwriting. The OAL Determination provides:

OAL disagrees with the requester that existing law, either statutory or regulatory, limits filing requirements to rates. For filing requirements that go beyond the filing of just “rates,” see Insurance Code section 1861.05(b) (“such other information as the commissioner may require”) and Title 10, CCR, sections 2643.3(b) (“require the filing of such other information as he or she deems necessary to review the application and 2648.4(b) (“submission of relevant underwriting rules”).

Indeed, as the Office of Administrative Law pointed out, there are myriad examples in the current law where the Commissioner takes jurisdiction over underwriting as well as rates as is reviewed in detail below.

CIC §1861.05(b) provides: “Every insurer which desires to change any rate shall file a complete rate application with the commissioner. A complete rate application shall include all data referred to in Sections 1857.7, 1857.9, . . . and 1864 and such other information as the commissioner may require.” The proposed regulation deals specifically with insurance underwriting and specifically requires the keeping of information relating to declination and nonrenewal of insurance policies. Certainly, at the very least, this type of information would fall into the category of “other information.” As such, this regulation, through the use of concrete examples, makes more specific this section.

CIC §1861.03(a) provides: (a) The business of insurance shall be subject to the laws of California applicable to any other business, including, but not limited to, the Unruh Civil Rights Act (Sections 51 to 53, inclusive, of the Civil Code), and the antitrust and unfair business practices laws (Parts 2 (commencing with Section 16600) and 3 (commencing with Section 17500) of Division 7 of the Business and Professions Code).

It is clearly within the realm of possibility that an underwriting guideline, either as written or as applied, might run afoul of the Unruh Act. In such a case, the underwriting guideline would most likely be unfairly discriminatory within the meaning of CIC §1861.05(a). The underwriting guideline might also be an unfair insurance practice within the meaning of CIC

§790.06. This regulation, through the use of concrete examples, makes more specific this section.

CIC §12926 provides that the commissioner shall require compliance from every insurer with all the provisions of the CIC. This regulation, by clarifying residential property underwriting requirements, makes more specific this section of the CIC as it relates to residential property underwriting.

CCR §2360.0 provides: “Eligibility Guidelines” are specific, objective factors, or categories of specific, objective factors, which are selected and/or defined by an insurer, and which have a substantial relationship to an insured’s loss **exposure**. Cited as authority for this regulation is CIC §1861.05. The proposed regulation, through the use of concrete examples, compliments this section.

CCR §2360.2 requires insurers to “maintain eligibility guidelines for every line of insurance offered for sale to the public.” The Eligibility Guidelines shall be sufficiently detailed to determine the appropriate plan for the insured.” Cited as authority for this regulation is CIC §1861.05. The proposed regulation is similar in application yet more narrow in scope as it applies to only residential property insurance. This regulation, through the use of concrete examples, compliments this section.

CCR §2648.4 sets forth the requirement for a complete rate change application. Subsection (b) clearly refers to “underwriting rules” which includes underwriting guidelines. Cited as authority for this regulation is CIC §1861.05. The proposed regulation is similar in application yet more narrow in scope as it applies to only residential property insurance. This regulation, through the use of concrete examples, compliments this section.

Conclusion

The proposed regulation, through the use of concrete examples, implements, interprets and makes specific several CIC sections.

As to the Commissioner’s authority to promulgate these regulations, it is illogical to take the position that while the Commissioner has jurisdiction over “rates,” which in most cases are simply numbers, he may not have jurisdiction over how those rates are applied. It is illogical to believe the Commissioner has authority to prevent unfair discrimination in rates, but does not have jurisdiction over eligibility guidelines which set forth the perimeters regarding who will be written, which necessarily changes the pool of risk, and therefore directly effects losses which are a major component of rates. It is illogical to believe the Commissioner has no authority to review any and all records of an insurer, to ensure the insurer is in compliance with all provisions of the CIC and CCR, and to bring enforcement actions where necessary.

2. Description of Specific Provisions

The following are statements of specific purpose and effect of each section of the proposed regulation including the rationale for the determination that each subdivision is reasonably

necessary to carry out the purpose for which it is proposed. The public problem has been discussed in detail. This proposed regulation is designed to address the homeowners insurance availability crisis in California.

Proposed California Code of Regulations section 2361(a)

The proposed subsection states that proposed California Code of Regulations (CCR) section 2361, subsections (a) through (f) apply to residential property risks subject to California Insurance Code (CIC) section 675. This subsection defines the scope and applicability of proposed CCR §2361.

Proposed California Code of Regulations section 2361(b)

This proposed subsection set forth definitions for the terms used substantively in the section. The subsection sets forth the scope and applicability of the proposed section by providing that the definitions apply when an insurer considers losses or loss exposure in residential property insurance rating and underwriting.

Proposed California Code of Regulations section 2361(b)(1)

This proposed subsection defines the term “substantial relationship to loss exposure” by providing that a substantial relationship to the loss exposure exists when a hazard, physical condition, or liability exposure creates a material and identifiable effect on the likelihood of a covered loss.

The Commissioner believes that the term “substantial relationship to risk of loss exposure” has been the cause of some confusion for the insurance industry. This confusion is in part the source of a lack of availability in the homeowners insurance market. The stated purpose of Proposition 103 “is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians.” The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

This proposed subsection is intended to define the term “substantial relationship to risk of loss exposure” in a clear and concise manner to better facilitate insurance industry understanding of the meaning of the term. Where the term is substantively applied the intent is to make specific the meaning of the term and its relationship to other applicable and relevant insurance laws.

Proposed California Code of Regulations section 2361(b)(2)

This proposed subsection defines the term “increased risk of loss” by providing an increased risk of loss exists when a property or liability hazard or physical condition is identified or discovered which both bears a substantial relationship to the loss exposure and presents a greater likelihood of future loss than if the hazard or condition did not exist.

The Commissioner believes that the term “increased risk of loss” has been the cause of some confusion for the insurance industry. This confusion is in part the source of a lack of availability in the homeowners insurance market. The stated purpose of Proposition 103 "is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

This proposed subsection is designed to define the term “increased risk of loss” in a clear and concise manner to better facilitate insurance industry understanding of the meaning of the term. Where the term is substantively applied the intent is to make specific the meaning of the term and its relationship to other applicable and relevant insurance laws.

Proposed California Code of Regulations section 2361(b)(3)

This proposed subsection set forth definitions for the terms used substantively in the section. The subsection sets forth the scope and applicability of the proposed section by providing that the definitions apply when an insurer considers losses or loss exposure in residential property insurance rating and underwriting.

This subsection specifically defines the term “fully remedied or otherwise resolved.”

The intent is to make clear the meaning of the term as used substantively later in the regulation.

Proposed California Code of Regulations section 2361(b)(3)(i)

This subsection defines a fully remedied or otherwise resolved loss or loss exposure as existing when the property has been returned to a state of repair that is equal or superior to the condition existing prior to the occurrence or condition which created the increased risk of loss.

For example, where there is a claim based on water damage caused by a leaky roof and the roof is replaced, that situation would be considered fully remedied or otherwise resolved.

The Commissioner believes that the term “fully remedied or otherwise resolved” needs to be defined in order to avoid confusion that may impact availability in the homeowners insurance market. The stated purpose of Proposition 103 "is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

This proposed subsection is designed to define the term in a clear and concise manner to better facilitate insurance industry understanding of the meaning of the term. Where the term is substantively applied the intent is to make specific the meaning of the term and its relationship to other applicable and relevant insurance laws.

Proposed California Code of Regulations section 2361(b)(3)(ii)

This subsection defines a fully remedied or otherwise resolved loss or loss exposure as existing when the liability hazard insured against has been reduced to equal or below the level existing prior to the loss or loss exposure.

For example, where there is a claim based on electric wiring and the entire system has been fully upgraded, in that situation the hazard insured against would have been reduced to equal or below the prior existing level.

The Commissioner believes that the term “fully remedied or otherwise resolved” needs to be defined in order to avoid confusion that may impact availability in the homeowners insurance market. The stated purpose of Proposition 103 “is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians.” The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

This proposed subsection is designed to define the term in a clear and concise manner to better facilitate insurance industry understanding of the meaning of the term. Where the term is substantively applied the intent is to make specific the meaning of the term and its relationship to other applicable and relevant insurance laws.

Proposed California Code of Regulations section 2361(b)(3)(iii)

This subsection defines a fully remedied or otherwise resolved loss or loss exposure as existing when the increased risk of loss has been entirely eliminated because the property is no longer owned by the insured, the liability hazard is no longer the responsibility of the insured, the policy no longer provides coverage for that exposure, or the condition that caused the increased risk of loss has been removed.

For example where the loss is based on the insured’s dog, where the insured no longer has a dog, the hazard insured against has been completely eliminated.

The Commissioner believes that the term “fully remedied or otherwise resolved” needs to be defined in order to avoid confusion that may impact availability in the homeowners insurance market. The stated purpose of Proposition 103 “is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and

affordable for all Californians." The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

This proposed subsection is designed to define the term in a clear and concise manner to better facilitate insurance industry understanding of the meaning of the term. Where the term is substantively applied the intent is to make specific the meaning of the term and its relationship to other applicable and relevant insurance laws.

Proposed California Code of Regulations section 2361(b)(4)

This proposed subsection defines the term adverse underwriting by referring to California Insurance Code Section 791.02.

The Commissioner believes this definition and reference is necessary to ensure the entities to which this regulation will apply have a clear and concise understanding of the use and application of the term.

Proposed California Code of Regulations section 2361(c)

This proposed subsection provides that where an adverse underwriting decision is based on losses or loss exposure, when otherwise allowed by law, the adverse underwriting decision shall be based upon conditions of the individual risk which bear a substantial relationship to the loss exposure and which present an increased risk of loss when compared to other risks eligible for coverage under the insurer's underwriting guidelines.

This proposed subsection also provides that an insurer shall not base, in whole or in part, an adverse underwriting decision on losses or loss exposures that have been fully remedied or otherwise resolved. The proposed subsection provides that losses or loss exposures that have been fully remedied or otherwise resolved are no longer substantially related to the risk of loss.

The Commissioner believes that this subsection is required in order to make clear the application of this section, and to also make clear how the various defined terms interact. This section is necessary to promote proper underwriting in the homeowners lines of insurance. This section is also necessary in order to avoid confusion that may impact availability in the homeowners insurance market. The stated purpose of Proposition 103 "is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

The intent of this proposed subsection is to make clear that there can be no justification for basing an adverse underwriting decision on losses or loss exposures which no longer exist because they bear no relationship to the risk of loss.

This proposed subsection is designed to make application of the section clear and concise to better facilitate insurance industry understanding of the meaning of the term.

Proposed California Code of Regulations section 2361(d)

This proposed subsection provides that an insurer shall not base an adverse underwriting decision, in whole or in part, on an inquiry regarding coverage, unless a hazard or condition is identified which both bears a substantial relationship to loss exposure and presents an increased risk of loss.

The intent of this proposed subsection is to make clear that mere inquiries cannot be used to form the basis of an adverse underwriting decision because inquiries bear no relationship to the future risk of loss. An inquiry about mold coverage does not cause the house to get toxic mold.

The Commissioner believes that this subsection is required in order to make clear the application of this section, and to also make clear how the various defined terms interact. This section is necessary to promote proper underwriting in the homeowners lines of insurance. This section is also necessary in order to avoid confusion that may impact availability in the homeowners insurance market. The stated purpose of Proposition 103 "is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

This proposed subsection is designed to make application of the section clear and concise to better facilitate insurance industry understanding of the meaning of the term.

Proposed California Code of Regulations section 2361(e)

This proposed subsection provides that that an insurer shall gather adequate information to determine that an increased risk of loss exists before a loss, loss exposure, or an inquiry with respect to coverage can be used as grounds for an adverse underwriting decision. The proposed section adds that in accordance with California Insurance Code Section 791.12, an insurer cannot rely solely on information obtained from an insurance-support organization. The proposed section also provides that if the information is from an insurance support-organization, the insurer shall obtain further relevant information in addition to the material obtained from the insurance-support organization. Sources for this information may include the insurance application or supplemental application, telephone inquiry, written inquiry, and physical inspection.

It is the intent of this proposed regulation to make clear that an adverse underwriting decision must be based on exposure to loss, therefore an insurer must gather sufficient information to make a reasonable determination about what the actual loss exposure is before using that loss exposure to rate the policy.

The Commissioner believes that this subsection is required in order to make clear the application of this section, and to also make clear how the various defined terms interact. This section is necessary to promote proper underwriting in the homeowners lines of insurance. This section is also necessary in order to avoid confusion that may impact availability in the homeowners insurance market. The stated purpose of Proposition 103 "is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians." The Commissioner is charged with enforcing Proposition 103 and all other CIC provisions. The Commissioner believes proposing this definition, and the other definitions contained herein, is necessary to ensure homeowners insurance remains available in California.

This proposed subsection is designed to make application of the section clear and concise to better facilitate insurance industry understanding of the meaning of the term.

Proposed California Code of Regulations section 2361(f)

The proposed section provides that where an insurer makes an adverse underwriting decision, the insurer shall maintain documentation detailing the hazards or physical conditions which created an increased risk of loss and how this information was considered in policy rating or underwriting. The proposed subsection adds that this documentation shall be maintained during the time in which the policy is in force and otherwise as required by law.

The Commissioner believes that this subsection is required in order to make clear the application of this section, and to also make clear how the various defined terms interact. This section is necessary to promote proper underwriting in the homeowners lines of insurance. This section is also necessary to enable CDI to verify compliance with the insurance laws.

This proposed subsection is designed to make application of the section clear and concise to better facilitate insurance industry understanding of the meaning of the term.

3. Federal law

There is no existing, comparable federal regulation or statute.

4. Small Business

The proposed regulation has no effect on small business in the state of California.

F. Specific Agency Statutory Requirements

On June 27, 2003, in compliance with California Insurance Code Section 12921.7, a notice of proposed emergency action was mailed by CDI to every person, group, or association that had previously filed a request with the Commissioner for notice of regulatory action. The same notice was mailed to every property and casualty insurer licensed to do business in California. A copy of the Notice and proof of mailing was submitted to OAL on July 10, 2003.

G. Fiscal Impact / Cost Statement / Local Mandate Determination

The Commissioner has determined that the regulatory action imposed herein will result in no program mandates on local agencies.

H. Fiscal Impact / Cost Statement / Local Agencies and School Districts

The Commissioner has determined that the regulatory action imposed herein will result in no program mandates on local agencies or school districts.

I. Cost Statement

The Commissioner has determined that this regulation does not impose any cost or result in any savings to any state agency, local agency, or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of the Government Code, nor does the regulation cause any other non-discretionary cost or savings imposed on local agencies, nor does the regulation have any effect on federal funding to the state.

J. Pre-adoption consultation with interested persons.

On March 12, 2003, the Commissioner invited any and all interested parties to a meeting in Sacramento where the legal theories underlying these regulations were discussed publicly with many representatives of the insurance industry and consumer groups as well.

Although this was not a public discussion regarding the proposed regulations as contained in Government Code Section 11346.45, the purpose of the discussion was to seek public participation and obtain input by those parties who will be subject to these proposed regulations.

While the Commissioner has done everything in his power to work with the insurance industry and consumer groups to find solutions to the various problems facing the homeowners insurance market in California, no interested person was consulted specifically in relation to this proposed regulation.

K. Fiscal Impact Estimate/Form 399

The Fiscal Impact Estimate/Form 399 was submitted to OAL on July 10, 2003.